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May 14, 2001

Honorable John Dingell
Ranking Minority Member, Committee on Commerce
U.S. House of Representatives
Washington, D.C. 20515

Honorable Edward J. Markey
U.S. House of Representatives
Washington, D.C. 20515

Honorable Nick Lampson
U.S. House of Representatives
Washington, D.C. 20515

Re: Comment on Correspondence from GAO entitled "*Steps Taken to Address the Problem of Unpaid Arbitration Awards.*"

Dear Congressmen:

Last year, I forwarded correspondence to all of you regarding this situation, which the Mr. Dingell then kindly forwarded to the GAO for comment. As I noted in my earlier correspondence, the proposed action, now being implemented, to solve this very serious problem was then and is now totally insipid. That process is aimed at studying the problem, a typical non-solution used by those seeking to bury a problem in paperwork and maintain the status quo, with their goal to avoid any cost to them brought about by the solution. Thus, the present actions, as earlier presented and now implemented, will yield no substantive results and are an exercise which gives taxpayers nothing for their money and, more importantly, no relief to the increasing number of victims of brokerage fraud.

Let me again attempt to encourage you to recognize the gravity of the situation:

STOCK BROKERAGE FRAUD HAS REACHED EPIDEMIC PROPORTIONS AND NOW INFLECTS FINANCIAL DAMAGE TO THE AMERICAN PUBLIC LARGER THAN ALL OTHER FORMS OF CONSUMER FRAUD COMBINED!

I will not bother to again dismantle the current efforts of these bureaucracies except to summarize: None of the "actions" taken will deter or prevent the damage. I ask you: If there were thousands of criminals robbing multi-millions of dollars from brokerage firms, would the efforts by the GAO and others involved be designed to "quantify" the problem? No! The prevailing interests here would have long ago motivated legislatures and regulators into action to end their own plight. We should be certain that motivation for action is not based only upon "Whose ox is gored?"

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In my earlier correspondence I stated: "I know and you know that the only workable solution to the problem is to require insurance. It has been my experience that some properly run small brokerage firms require their brokers to carry insurance. The cost to good brokers is not prohibitive. Just as good drivers can afford liability insurance - and bad drivers cannot - so too can good brokers and their firms afford insurance.

The GAO's response to your request for comment, and my rebuttal, is as follows:

GAO: *"Our June 2000 report discussed the notion of insurance coverage of unpaid awards. In that report we noted the views of the SEC, NASD, the Securities Investor Protection Corporation (SIPC), and the Securities Industry Association.*

Comment: The NASD, Inc. is a corporation owned by brokerage firms, set up as a non-profit organization which can be in many ways compared to, if you will, most country clubs. The Securities Industry Association (SIA) is even more biased, with lobbying on behalf of brokerage firms as a primary purpose. SIPC has been properly described by the GAO as "a non-profit membership corporation of broker-dealers". This leaves only the SEC, the police of the securities industry which, however, apparently relies on such "brain trusts" as the GAO (and whose membership is to a large extent the product of the SIA's lobbying efforts). In short, the proverbial "fox" is in charge of this "hen house".

GAO: *"These officials expressed concern that expanding SIPC coverage, for example, to include unpaid arbitration awards would quickly exhaust the SIPC fund (of about \$1.1 billion) if annual payments were to be as high as the \$129 million that we estimated for 1998."*

Comment: Using the GAO's statistics (and adding interest earned on these funds), without consideration of either future premiums or increased premiums, SIPC's current reserves would not be exhausted for more than a decade. Moreover, it is my understanding there are far in excess of 100,000 NASD registered representatives in the brokerage industry (each generating average gross revenues of considerably more than \$200,000). If premiums for each of these representatives were only \$100 per month, annual new receipts to SIPC would exceed \$120 million, which would solve the problem of unpaid awards.

GAO: *They [the "officials"] also said covering unpaid awards would increase SIPC's caseload requiring SIPC to expand and increasingly its need for resources.*

Comment: It is my understanding that SIPC has an "ivory tower" in Washington, D.C., and a large staff of highly paid persons, including lawyers, all with very large pension funds, yet has a tiny caseload. Furthermore, my earlier point was that if closer scrutiny were given to

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brokers, much as insurance companies do with motorists, "reckless" brokers would pay higher premiums, which would cover any additional costs to SIPC. Currently those brokers with multiple "hits" for past actions on their records find themselves at the very firms which do not pay awards, where they continue to inflict havoc upon the public. (We should also note that the bandit firms all use larger "clearing firms", which are major players and who derive mega-bucks from interest on the cleared accounts and on transaction fees. For them, crime pays.) Higher costs to the brokers and their firms who are the "financial serial killers", pricing some even out of existence, would serve as a part of the solution - using free-market principals.

GAO: They [the "officials"] also expressed concern that expanding SIPC coverage could increase costs for broker-dealers and investors, might encourage frivolous arbitration claims and might reduce the incentives to carefully choose their brokers and investments.

Comment: The issue of increased costs to broker-dealers was addressed above, but also consider that the brokerage industry has annual revenues more than \$100 billion. If but one-percent of these revenues went to insure its members' conduct, more than \$1 billion would become available to compensate those harmed by wrongdoing. As for increased costs to investors: It is my understanding there are now 60 million investors. If the earlier described monthly premiums for "awards insurance" were passed-on to the consumer, the cost to each investor would be in the range of \$2 each per year. As to the unfortunate comment on "frivolous arbitration claims", I note that the term "frivolous arbitration claims" is practically an oxymoron. One member of the securities industry sits on each arbitration panel and arbitrators are notoriously known as highly conservative in their awards. (Numerous articles in this regard have appeared in financial and other publications, under such titles as "The Stingiest Judges on Wall Street".) The final comment by the GAO - that "this might reduce incentives to carefully chose their brokers and investments" only deserves note for its absurdity. With all its "studies", we trust that even the GAO would be unable to provide empirical data to support that premise.

GAO: The same officials said that establishing a separate insurance fund to cover unpaid arbitration awards would pose the same problems.

Comment: Undue merit should not be given to these biased (and unnamed) sources by labeling them as "officials". Furthermore, rather than "posing the same problems", application of the above analysis to a separate insurance fund, whether private, public or quasi-public, to cover unpaid arbitration awards instead poses the same solution.

GAO: Insurance coverage of unpaid arbitration awards thus could impose additional costs and burdens of investors and other market participants. However, insurance coverage would not serve to prevent fraudulent practices or punish unscrupulous brokers.

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Comment: As demonstrated above, the unsupported statements of the GAO concerning costs have no merit. Congress has stated that the primary goal of securities regulators is to "protect the public", such that establishing a means of protection should be the first, not last, alternative. It is clear that the GAO, and its "officials", have focused their attention on everything but mandatory insurance, the best solution to protect the public. Applying sound actuarial principles of private, public or quasi-public insurance would reduce the problem while also preventing fraudulent practices by excluding "uninsurable" perpetrators and discouraging others on a cost basis.. Meanwhile, as civil arbitration proceedings serve as a deterrent ("private attorney general" style), regulatory efforts would also be assisted if filings and findings in arbitration proceedings were used by regulators to help catch wrongdoers. There are several thousand arbitration actions filed each year, while the NASD and SEC are overloaded by a few hundred regulatory actions. The regulatory problem is too large for current regulators and the solution is to either hire thousands more "securities police", or utilize the hard work of investors, their attorneys and arbitrators in uncovering securities fraud. However, this valuable resource is lost when firms go out of business because seeking recovery in arbitration from wrongdoers is not economically viable.

GAO: *"In order to be equitably and effectively implemented, such insurance, therefore, would need to be carefully examined and any attendant problems resolved."*

Comment: In this its final statement regarding the subject the GAO deserves some applause, since it gives credibility to examination of insurance as a solution. We strongly encourage the Committee to eschew much of the GAO's evaluation, including studies of the after-effects of the earthquake of brokerage fraud and focus instead on disaster insurance for the victims.

In summary, it is clear the GAO has given little attention a the task you presented to it regarding insurance. Expansion of SIPC coverage to include fraudulent practices by brokers and their firms, or requirement of private insurance, is economically viable. Furthermore, increasing or implementing such insurance will also serve a regulatory function, both to reduce the strain on governmental and quasi-governmental staffs as well as to create economic deterrent in a preventative manner, before-the-fact rather than after-the-fact, as virtually all current efforts are aimed.

I appreciate your consideration and continue laud your efforts to solve the problems of the securities industry. I and the other members of the Public Investors Arbitration Bar Association (PIABA) are available for additional information and comment in this and other regard. While we find ourselves as the "David" in this battle with the "Goliath" of the securities industry, we offer to appear, sling in hand, for any hearings which may be held in these matters.

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Very truly yours,

A handwritten signature in black ink, appearing to read 'W. S. Shepherd', written in a cursive style.

William S. Shepherd

WSS/kw

cc: Richard J. Hillman, Director; Financial Markets and Community Investment, GAO
All Members of the Board of Directors of PIABA